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Financial Markets

Irving Trust

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Friday (Noon) Dec. 2, 1983

Recent policymaking at the Fed has been conducted in a very rarefied atmosphere. FOMC notes (released Nov. 18) indicate that the Fed eased its policy sometime between late August and early October. Yet over the last three weeks, net borrowed reserve figures indicate a desire for greater tightness on the part of the Fed--but wait, there's more! Over the last two weeks, Fed funds have persisted in trading 12 basis points below their earlier levels. Such activities can have no other impact than to thoroughly confuse market participants. Can there be any explanation for such seemingly inconsistent actions?

There is an explanation; part of it was given in last week's "Financial Markets" letter: The Fed had eased expecting the economy to cool off, but the economy hasn't obliged. So now interest rates are at levels the Fed thought would be consistent with a weaker economy. Having made a forecast error, the Fed was (and is) faced with the dilemma of what to do about it. The closely watched net borrowed reserve figures have been fairly clear on one aspect of this: The Fed is not continuing to ease as it had been doing.

Although the seven-day reserve figures have clearly pointed to greater tightness, the Fed has failed to squeeze the day-to-day Fed funds market as tightly as the weekly average figures might indicate. Thus the Fed has used the seven-day reserve figures to operate on market psychology. By forcing the bulk of the net borrowings to fall late in the week, usually on Wednesday, the Fed funds market is not as tight Thursday through Tuesday as the seven-day reserve figures indicate. This explains why Fed funds rates can ease even in the presence of greater weekly (average) net borrowings.

Market participants have an intuitive understanding of these procedures. Thus when the larger net borrowed figures appeared unaccompanied by firmer rates, the subtle signal came to be understood to mean that--at best--there was to be a cessation of easing. But the extreme subtlety, or tentativeness, of Fed policy allowed rates to slip lower for the weeks ended Nov. 23 and Nov. 30. Thanksgiving was a problem because it meant the Fed could not force high borrowings on Wednesday (Nov. 23) unless it wanted to start out the next week in a reserve deficient position--a very aggressive move. On balance, the Fed seems to be using the reserve figures to send a warning, but it is being much more careful with the day-to-day liquidity needs of the Fed funds market. The Fed may have eased "too soon," but now its policies are on hold and the economy is in the spotlight. The more robust the economy, the more the Fed's day-to-day reserve positions will come to resemble what is indicated by the seven-day reserve figures. Still the Fed will be tilted toward caution this holiday season, even if the economic statistics of November and December look good.

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Market Yields

	12/2/83(Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00	11.00%	11.50
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	9.00
Federal Funds	9.50	9.25	8.88
Repurchase Agreements	9.40	8.88	8.75
U.S. Treasury Issues			
Bills			
3 months	9.22	9.11	8.14
6 months	9.64	9.48	8.72
1 year	9.99	10.11	9.07
Coupons			
2 years	10.73	10.50	9.70
4 years	11.26	11.13	10.30
7 years	11.64	11.50	10.58
10 years	11.70	11.75	10.46
Long Bond	11.75	12.00	10.47
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.30	9.20	8.50
3 months	9.40	9.25	8.65
6 months	9.60	9.45	8.80
1 year	10.15	10.05	9.20
Banker's Acceptances			
1 month	9.33	9.20	8.50
3 months	9.47	9.35	8.65
6 months	9.69	9.47	8.90
Eurodollar Deposits			
1 month	9.75	9.50	9.31
2 months	9.81	9.81	9.50
3 months	9.88	9.88	9.63
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.29	9.01	8.76
1 month	9.33	9.25	8.68
3 months	9.49	9.44	8.68
Bank Holding Companies			
1 month	8.94	9.30	7.65
Dealer Placed:			
3 months	9.44	9.39	8.41
New AA Corporate Utility Bond	13.00	12.90	12.00
Tax Exempt			
6 month Project Notes	5.50	5.45	4.85
1 year AAA Bond	5.50	5.50	5.00
5 year AAA Bond	7.45	7.25	7.00
20 year AAA Bond	9.40	9.40	9.50

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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